

# On Nonprofits, Taxation, *and the* Public Trust

by Ruth McCambridge



**T**HERE HAVE BEEN many proposals floated at various levels of government to tax nonprofits, and most of them have not succeeded.<sup>1</sup> But some have—in particular, at the federal level, the recent taxing of extraordinarily high university endowments and extraordinarily high nonprofit salaries.<sup>2</sup> In this article, I try to draw out why, beyond the political circumstances of the moment, those proposals succeeded. Additionally, I suggest that while most attempts to impose taxes on

nonprofits should be resisted, there is one exception that requires some cooperation.

## **The One Spring from Which the Benefits, Requirements, and Resentments of Tax Exemption Flow**

What can we make of the various waves of attempts to tax the tax exempt? Do they flow from a kind of callous disregard for the public good, or from disappointment with those who claim to serve that public good?

What happens to the way people think about nonprofits when Harvard University, sitting on top of the largest university endowment in the

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world—and known for its encroachment into certain lower income neighborhoods—decides that it is going to renege, year after year, on its payments in lieu of taxes (PILOTs) to the City of Boston?<sup>3</sup> There is no correlation between the amount of land Harvard owns and does not pay taxes on, and the amount it contributes “voluntarily” to make up for that loss to the city and its residents.<sup>4</sup> It alone, Harvard insists, is the judge of what it should be paying. (Of course, Harvard is not the only university to maintain such a stance; in New Haven, some call Yale “the plantation.”) And then there are the hospitals and other medical businesses. As I write this, a pharmaceutical company (also in Boston) is being tried in criminal court for multiple schemes to peddle opioids through doctors, and the same company has been accused of having too close relationships with nonprofit patient advocacy groups who subsidize those medications.<sup>5</sup> What impressions of the sector are we left with when we hear this, or when we discover that a ballot-question campaign to lift the cap on charter schools is being financed by those who would be in a position to benefit from their management—and that the funds are being funneled through a nonprofit?<sup>6</sup>

Also in this city: a nonprofit health insurer took the money its customers paid in ever-increasing and impossible rates, and paid a departing executive (who left after leading the organization through a period of underperformance) more than \$11 million in severance.<sup>7</sup> Later, the media surfaced the fact that the board members were additionally being paid high subsidies for showing up for a few hours a year, and that the possibility existed that the relationships among these actors were too interdependent to ensure that the organization was always acting in the best interests of its community.<sup>8</sup>

All this and more has happened in just one city, Boston, over the past few years.

So, am I surprised to hear that proposals to tax nonprofits are not just summarily dismissed by the right-minded? Was I surprised when Congress finally passed measures in the 2017 tax reform act that would essentially impose taxes on a few super-high salaries in the sector, and on

earnings from the highest of university endowments?<sup>9</sup> Not in the least.

In fact, what surprises me is that nonprofits retain enough of a halo to engender both faith and disappointment among the public—but that speaks to an incalculably deep spring of trust and need on the part of the public. The need has to do with this sector’s holding of the responsibility for the shared means of collective well-being—the commons. Some of that responsibility lies with government, of course, but too often government fails at the job of protecting or even noticing the margins or the requirements of a fair, just, and free society in future generations; for that, we have the civil sector in which to organize ourselves.

Recently, I came across an excellent paper by Rob Atkinson, titled “Theories of the Federal Tax Exemption for Charities: Thesis, Antithesis and Syntheses,” in which the author posits that nonprofits are afforded exemption based in part on the general role they are seen as playing in society and the ways in which they are expected to behave.<sup>10</sup> Some of those expectations are written into law—as, for instance, the nondistribution constraint, which is meant to reinforce the expectation that all earnings of the nonprofit are to be used toward its work rather than toward the enrichment of the few.

This guidance comes from the U.S. Tariff Act of 1913, which excluded public benefit nonprofits from paying federal income tax—the language reads that such organizations are exempt if “no part of the net income of which inures to the benefit of any private shareholder or individual.”<sup>11</sup> Thus, when salaries, or endowments with highly paid endowment managers, become too high, the public and representatives of the public may feel that the spirit of the exemption is being flouted. And, when the business being done by the organization flows through for-profit partners to enrich individuals, as was recently found to be the case at Memorial Sloan Kettering,<sup>12</sup> a violation is called—because in return for the tax exemption, the public wants to be assured that no one is using these organizations in a way that places his or her own individual interest above that of the public being served. Writes Atkinson,

Was I surprised when Congress finally passed measures in the 2017 tax reform act that would essentially impose taxes on a few super-high salaries in the sector, and on earnings from the highest of university endowments? Not in the least.

Nonprofits are fond of saying how much of our work is relationship- and reputation-based. . . . But the public evidently is capable of making the distinction among most nonprofits and the nonprofits (or nonprofit executives) that are enriching themselves in a way that is out of proportion to the public benefit they provide.

In the case of the charitable exemption, one intuition that we want our theories to explain is deeply held and not always clearly articulated. We are accustomed to thinking of the organizations in question here as virtuous in a way associated with the words “charity” and “philanthropy,” words related etymologically to the notion of selfless, other-regarding love. Moreover, we want an account of the charitable exemption in terms of that quality, an account that makes charity integral to the exemption, that shows the exemption to be tied to what makes the organizations charitable. A theory that does not make direct reference to this quality will disappoint us, even if it is elegant and internally consistent. We congratulate Laplace for moving the Unmoved Mover out of physics, but we are likely to be uncomfortable with theories that explain our intuitions about “charity” out of the charitable exemption.<sup>13</sup>

This assumption that nonprofits work to benefit the public in an overriding way is so deeply held that it is a fight we would have to work to lose; but, as suggested earlier, with enough carelessness over a long enough period of time, we certainly could begin to make a dent in it.

But Atkinson says that it is not only the assumption of good works that provides a general justification of tax benefit. He suggests that society also expects us to act in ways that are consistent with a certain cluster of values:

Bear in mind that we have looked thus far only at the kinds of good or service charities provide, ignoring any reasons for favoring charities based on the way they provide goods and services. We have, in other words, focused on the primary benefits charities provide, ignoring the metabenefits side of traditional subsidy theory. In this we are being faithful to the subsidy theory in its classic expressions. The asserted metabenefits of efficiency, pluralism, and diversity figured in more as rhetorical flourishes than as integral

components of an exemption rationale, sometimes as a broad normative defense of the nonprofit sector but never systematically as an explanation of its tax treatment.<sup>14</sup>

This appears to attach directly to the ability of this sector to promote civic and political behaviors consistent with a responsive and diverse society, and it is one of the more intriguing expectations the public has of us—and one of the most important. And Atkinson’s description of the responsibilities associated with that set of principles requires much of us in terms of observing the requirements of democracy:

I think the charitable exemption reflects not only a desire to promote the helping of others, but also a healthy agnosticism about how that help can best be given, a willingness on the part of the majority to promote minority conceptions of the good of others. That, ultimately, is what we are asking our fellows to promote when we defend the charitable exemption. To persuade them, we may have to show more than that we are helping others by our own lights; we may have to point to the minor metabenefits that fall outside Grand Theory, and we may have to assure them that we are mindful of metaharms like racial discrimination. In fairness, too, we must tell them how much helping others our way will cost. On this issue, economics will have much to tell us. But whether we assume those costs will depend, ultimately, on what kind of society we want to live in. That, I’m afraid, we will have to decide for ourselves.<sup>15</sup>

## The Social Contract Is Ours to Break

Nonprofits are fond of saying how much of our work is relationship- and reputation-based, and this is as true for the sector as a whole as it is for individual nonprofits. But the public evidently is capable of making the distinction among most nonprofits and the nonprofits (or nonprofit executives) that are enriching themselves in a way that is out of proportion to the public benefit they provide—thus, the taxation of high salaries and endowments. In fact, even in localities, attempts



to retrieve either property taxes or payments in lieu of taxes generally focus on the largest institutions and institutions that occupy a significant portion of the property tax base. In these cases, the *Nonprofit Quarterly* feels that those institutions should voluntarily attempt to recompense the surrounding community for an agreed-upon proportion of what the institution would have owed in tax payments were they on the rolls. That money should not be figured in kind but added as cash to city revenue. Not to do so will continue to feed resentment based on perceptions of commonsense fairness.

## NOTES

1. For more on this, see Tim Delaney, "Nonprofit Tax Policy—A Game of Three-Dimensional Chess," pp. 46–53 in this issue.
2. National Council of Nonprofits, "Tax Cuts and Jobs Act, H.R. 1: Nonprofit Analysis of the Final Tax Law," updated April 5, 2018, [www.councilofnonprofits.org/sites/default/files/documents/tax-bill-summary-chart.pdf](http://www.councilofnonprofits.org/sites/default/files/documents/tax-bill-summary-chart.pdf).
3. Steve Dubb, "Boston's Universities Shortchange City Government," *Nonprofit Quarterly*, August 8, 2018, [nonprofitquarterly.org/2018/08/08/bostons-universities-shortchange-city-government/](http://nonprofitquarterly.org/2018/08/08/bostons-universities-shortchange-city-government/).
4. Ruth McCambridge, "Harvard the Miser Shorts the City of Boston...Again," *Nonprofit Quarterly*, August 5, 2016, [nonprofitquarterly.org/2016/08/05/harvard-miser-shorts-city-boston/](http://nonprofitquarterly.org/2016/08/05/harvard-miser-shorts-city-boston/).
5. Jonathan Saltzman and Maria Cramer, "Opioid company executives set to go on trial in Boston Monday," *Boston Globe*, January 28, 2019, <https://www.bostonglobe.com/metro/2019/01/27/opioid-company-executives-set-trial-boston-monday/VCwGgRjHwdfh7uSWzRWsYO/story.html>; see also Ruth McCambridge, "Patient Advocacy Groups Lurk in the Shadows of Opioid Producer Criminal Trials," *Nonprofit Quarterly*, February 4, 2019, [nonprofitquarterly.org/2019/02/04/patient-advocacy-groups-lurk-in-the-shadows-of-opioid-producer-criminal-trials/](http://nonprofitquarterly.org/2019/02/04/patient-advocacy-groups-lurk-in-the-shadows-of-opioid-producer-criminal-trials/).
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7. Rick Cohen, "Massachusetts AG Coakley Examines

High Nonprofit Salaries," *Nonprofit Quarterly*, December 24, 2013, [nonprofitquarterly.org/2013/12/24/massachusetts-ag-coakley-examines-high-nonprofit-salaries/](http://nonprofitquarterly.org/2013/12/24/massachusetts-ag-coakley-examines-high-nonprofit-salaries/).

8. Jim Schaffer and Ruth McCambridge, "Should Board Members of Large Nonprofits Be Paid?," *Nonprofit Quarterly*, September 6, 2016, [nonprofitquarterly.org/2016/09/06/should-board-members-of-large-nonprofits-be-paid/](http://nonprofitquarterly.org/2016/09/06/should-board-members-of-large-nonprofits-be-paid/).

9. National Council of Nonprofits, "Tax Cuts and Jobs Act, H.R. 1."

10. Rob Atkinson, "Theories of the Federal Income Tax Exemption for Charities: Thesis, Antithesis, and Syntheses" (paper presented at the "Nonprofit Symposium," the 3rd Annual Conference of the New York University School of Law Program on Philanthropy and the Law, New York, October 11, 1991), [www.stetson.edu/law/lawreview/media/theories-of-the-federal-income-tax-exemption-for-charities-thesis-antithesis-and-syntheses-27-2.pdf](http://www.stetson.edu/law/lawreview/media/theories-of-the-federal-income-tax-exemption-for-charities-thesis-antithesis-and-syntheses-27-2.pdf).

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13. Atkinson, "Theories of the Federal Income Tax Exemption for Charities," 399.

14. *Ibid.*, 407.

15. *Ibid.*, 432.

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